

Bellaire Public Schools

FINANCIAL STATEMENTS
AND REPORT OF INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS

June 30, 2006

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Management's Discussion and Analysis

For the year ended June 30, 2006

Our discussion and analysis of Bellaire Public Schools' (the "District") financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2006. Please read this analysis in conjunction with the District's financial statements, which immediately follow this section.

Description of Reporting Entity and Services Provided

Bellaire Public Schools, located in Bellaire, Michigan in Antrim County, is located in between pristine lakes and watersheds. The school population for the 2005-2006 school year is 544 students who are eager to learn. Nine percent of the students in the district are "Schools of Choice" coming from Alba, Central Lake, Mancelona, Kalkaska, Elk Rapids, and Traverse City. Because of small class sizes, students are given more individual attention in the classroom. Educators are dedicated and caring and always look out the student's best interest. MEAP and standardized test scores are consistently above average. The community has been extremely supportive over the years and parents are very involved in the schools in a positive way whether it is fund raising, volunteering in the classrooms, or attending the many events at the school. Bellaire boasts outstanding athletic, drama and music programs that allow students to learn outside of the classroom.

Overview of the Financial Statements

This annual report consists of three sections presented in the following order: Management's discussion and analysis, the basic financial statements, and required supplementary information. The basic financial statements include two kinds of statements that present different views of the District:

- The first two statements are *district-wide financial statements* that provide comprehensive *short-term* and *long-term* financial information about the District as a whole.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the District, reporting the District's operations *in more detail* than the district-wide statements.
- The *governmental funds* statements tell how *basic* services like regular and special education were financed in the *short-term* as well as what remains for future spending.
- *Fiduciary funds* statements provide information about assets held by the District in a *trustee* or *agent* capacity.

The financial statements also include notes that explain some of the information in the statements and provide more detailed data and supporting documentation. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the District's budget for the year. Figure A-1 shows how the various parts of this annual report are arranged.

Figure A-1

District Financial Report Organization

Management's Discussion and Analysis (MD&A)
(Required Supplemental Information)

Basic Financial Statements

District-wide Financial Statements/ Fund Financial Statements

Notes to Basic Financial Statements

Budgetary Information for Funds
(Required Supplemental Information)

Other Supplemental Information

District-Wide Statements

The district-wide statements provide comprehensive information about the entire District using the accrual basis of accounting which is similar to the method used by private-sector companies. The statement of net assets includes all of the District's assets and liabilities and the difference between the two, which is net assets. The statement of activities accounts for all of the current year's revenues and expenses regardless of when cash is received or paid.

The statement of net assets and statement of activities report the governmental activities for the School District, which encompass all of the School District's services, including instruction and supporting services. Unrestricted State Aid and property taxes finance most of these activities.

The two district-wide statements report the District's *net assets* and how they have changed. Examining net assets is one way to measure the District's financial health or *position*. Over time, increases or decreases in the District's net assets are an indicator of whether its financial position is improving or declining. The relationship between revenues and expenses is the District's operating results, or in other terms, whether the District had a profit or a loss at year end. However, the District's mission is not simply to generate profits, as may be the case for a commercial entity.

Fund Financial Statements

The fund financial statements provide more detailed information about the District's funds. Each major fund is presented in a separate column. Non-major funds are aggregated and displayed in a single column. Funds are accounting devices the District uses to keep track of specific sources of funding and spending on particular programs. Some funds are required by State law and by bond covenants. The District has two kinds of funds:

Governmental funds:

All of the District's basic services are included in governmental funds. Governmental fund reporting generally focuses on how dollars flow in and out of the funds and the balances left at year-end. These balances are reported using the modified accrual basis of accounting. Revenues are recognized when they are measurable and available. Expenditures are recorded when the related fund liability is incurred. The governmental fund statements provide a detailed short-term view of the operations of the District and the services it provides. Governmental fund information helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. The relationship or differences between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds are presented in a reconciliation displayed further in our documentation. The District's major governmental fund is the general fund.

Fiduciary Funds:

The District is the Trustee, or fiduciary, for assets that belong to others. The District is responsible for ensuring that the assets reported in these funds are used only for their intended purposes, and only by those to whom the assets belong. We exclude these activities from the district-wide financial statements because the District cannot use these assets to finance its operations. The Student Activities Accounts are accounted for as fiduciary funds.

The District as a Whole

Recall that the statement of net assets provides the perspective of the District as a whole. Table 1 provides a summary of the District's net assets as of June 30, 2006:

TABLE 1

	Governmental Activities <u>2004-2005</u>	Governmental Activities <u>2005-2006</u>
Assets		
Current and other assets	\$1,456,369	\$ 16,964,981
Capital assets	<u>1,015,849</u>	<u>946,462</u>
Total assets	\$2,472,218	\$ 17,911,443
Liabilities		
Current liabilities	\$ 704,836	\$ 742,543
Long-term liabilities	<u>196,569</u>	<u>15,538,538</u>
Total liabilities	\$ 901,405	\$ 16,281,081
Net Assets		
Invested in capital assets, net of related debt	\$ 722,307	\$(14,566,549)
Restricted for Debt Service	16,693	34,667
Restricted for capital project	-	15,772,905
Restricted for school-based activities	-	5,499
Unrestricted	<u>831,813</u>	<u>383,840</u>
Total net assets	<u>\$1,570,813</u>	<u>\$ 1,630,362</u>

The above analysis focuses on the net assets (see Table 1). The District's net assets were \$1,630,362 at June 30, 2006. Restricted net assets are reported separately to show legal constraints from debt covenants and enabling legislation that limit the District's ability to use those net assets for day-to-day operations. The District has \$15,813,071 restricted net assets. The remaining amount of net assets \$383,840 was unrestricted.

The \$383,840 in unrestricted net assets of governmental activities represents the accumulated results of all past years' operations. It means that if we had to pay off all of our bills today, including all of our non-capital liabilities; we would have \$383,840 remaining. The operating results of the District will have a significant impact on the change in unrestricted net assets from year to year.

The results of this year's operations for the District as a whole are reported in the statement of activities (see Table 2), which shows the changes in net assets for fiscal year 2006.

TABLE 2

	Governmental Activities <u>2004-2005</u>	Governmental Activities <u>2005-2006</u>
Revenue:		
Program revenue:		
Charges for services	\$ 106,419	\$ 108,406
Operating grants and contributions	490,468	382,621
General revenue:		
Property taxes	3,631,297	3,694,343
State School Aid- unrestricted	847,102	574,259
Other	<u>154,858</u>	<u>324,475</u>
Total revenues	<u>\$5,230,144</u>	<u>\$5,084,104</u>
Functions/Program Expenses:		
Instruction	\$3,053,848	\$2,863,852
Support services	1,806,816	1,692,602
Food Services	127,610	127,916
Athletics	153,555	161,611
Cost on Long Term Debt	17,120	6,725
Depreciation (unallocated)	88,010	69,387
Other transactions	<u>67,576</u>	<u>102,462</u>
Total expenses	<u>\$5,314,535</u>	<u>\$5,024,555</u>
Increase (decrease) in Net Assets	<u>\$ (84,391)</u>	<u>\$ 59,549</u>

As reported in the statement of activities, the cost of all of our governmental activities this year was \$5,024,555. Certain activities were partially funded from those who benefited from the programs (\$108,406) or by other grants and contributions (\$382,621). We paid for the remaining “public benefit” portion of our governmental activities with \$3,694,343 in taxes, \$574,259 in State Aid, and with our other revenues including interest income, ISD transfers and general entitlements.

The District experienced an increase in net assets of \$59,549. Key reasons for the change in net assets were due to the conservative approach the District took on spending due to the poor economic condition of the State.

As discussed above, the net cost shows the financial burden that was placed on the State and the District’s taxpayers by each of these functions. Since property taxes for operations and unrestricted State Aid constitute the vast majority of District operating revenue sources, the School Board and Administration must annually evaluate the needs of the District and balance those needs with State prescribed available unrestricted resources.

The District's Funds

As noted earlier, the District uses fund accounting to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the District is being accountable for the resources taxpayers and others provide to it and may provide more insight into the District's overall financial health. The District's budgets are prepared according to Michigan law. The most significant budgeted fund is the General Fund. The General Fund is the main operating fund of the District. All other funds would be used to account for the proceeds from specific revenue sources that are legally restricted to certain types of expenditures.

As the District completed this year, the governmental funds reported a combined fund balance of \$16,287,520, which is an increase of \$15,389,938 from the prior year. The primary reason for the increase was due to successful passage of the bond issue of \$15,570,000, funds which are residing in the Capital Projects Fund waiting for construction to start.

Fund Budgetary Highlights

Over the course of the year, the District revises its budget as it attempts to deal with numerous changes in expected revenues and expenditures. The Uniform Budget Act of the State of Michigan requires that the Board of Education adopt a budget for the upcoming school year prior to July 1, which is the start of the new fiscal year. The District revised its budget two times during the fiscal year. Under normal circumstances, the District adjusts its budget to reflect a wide variety of federal and state programs, many of which are not finalized until well after the District's original budget is required to be adopted.

A schedule showing the District's original and final budget amounts compared with amounts actually paid and received is provided in required supplemental information of these financial statements. Changes to the general fund budget were as follows:

- Final budgeted revenues increased by \$141,910 over the original budget mainly due to the conservative state aid calculation that was used as well as conservative estimates on projected student enrollment.

- Final budgeted expenditures increased \$113,459 from the original budget to due to adjustments in staffing levels. Adjustments in staffing levels were needed once final student counts were obtained, increased numbers in special education areas, and settlement of contracts with both union groups.

Capital Asset and Debt Administration

Capital Assets

At June 30, 2006, the District had \$946,462 invested in a range of capital assets including buildings, land, furniture, equipment and vehicles summarized as follows:

	Balance <u>June 30, 2005</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2006</u>
Land Improvements	\$ 469,387	\$ -	\$ -	\$ 469,387
Buildings & Improvements	2,219,418	-	-	2,219,418
Furniture & Equipment	227,285	-	-	227,285
Buses & Vehicles	<u>531,109</u>	<u>-</u>	<u>-</u>	<u>531,109</u>
 Total capital assets	 3,447,199	 -	 -	 3,447,199
 Less: Accumulated Depreciation	 (2,432,262)	 (69,387)	 -	 (2,501,649)
Land	<u>912</u>	<u>-</u>	<u>-</u>	<u>912</u>
 Total capital assets, net	 <u>\$1,015,849</u>	 <u>\$(69,387)</u>	 <u>\$ -</u>	 <u>\$ 946,462</u>

Depreciation expense of \$69,387 was unallocated.

Long-term Debt

The District had a long-term debt beginning balance of \$436,569. At June 30, 2006 the long-term debt ending balance was \$15,657,989 which was composed of \$15,513,011 in 2006 School Improvement Bonds and \$89,664 in Accumulated leave liability and \$55,314 in Early Retirement Incentive.

Economic Factors and Next Year's Budgets and Rates

At the time these financial statements were prepared and audited, the District was aware of a number of circumstances that could significantly affect the financial health of Bellaire Public Schools.

- The current retirement rate is 16.34%. The retirement rate will increase to 17.74% in 2006-2007. Containment of costs within the retirement system continues to be a concern for all Michigan school districts.
- Pressures on health insurance premiums are a continuing problem. The district has been experiencing double-digit increases.
- We continue to be very concerned about the State of Michigan's revenue picture. The State Aid bill for the 2006-2007 school year has been finalized. The student foundation allowance will increase by \$210 per pupil for the upcoming school year. Unfortunately, between increases in health insurance and retirement costs, no additional dollars will be available for classroom use.
- The District has had four straight years of declining enrollment. The Board and Administration has continued to look at ways to market the District as a "School of Choice" for Antrim County. With over 95% of the District's revenue coming from students enrolled, this continues to be a major factor in our decisions on the budget.

Contacting the School District's Financial Management

This financial report is designed to provide the District's citizens, taxpayers, customers, and investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact James Emery, Superintendent, Bellaire Public Schools, 204 W. Forest Home Avenue, Bellaire, MI 49615. We can be reached by telephone at (231)533-8141.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Education
Bellaire Public Schools

We have audited the accompanying financial statements of governmental activities, each major fund and the aggregate remaining fund information of the **Bellaire Public Schools** (the "School District") as of and for the year ended June 30, 2006, which collectively comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material aspects, the respective financial position of the governmental activities, each major fund and the aggregate remaining fund information of the Bellaire Public Schools as of June 30, 2006, and the respective changes in financial position, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 27, 2006, on our consideration of the School District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages i - viii and the budgetary comparison information on page 27, are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the School District's basic financial statements. The combining non-major fund financial statements on pages 29 - 32 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining non-major fund financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Dennis, Gartland & Niergarth

July 27, 2006

Bellaire Public Schools

STATEMENT OF NET ASSETS

June 30, 2006

Governmental Activities

ASSETS

Current assets

Cash and cash equivalents	\$ 16,167,923
Investments	615,607
Due from other governments	152,214
Taxes receivable	16,641
Accounts receivable	6,429
Inventory	<u>6,167</u>

Total current assets 16,964,981

Capital assets, net of accumulated depreciation 946,462

Total assets \$ 17,911,443

LIABILITIES AND NET ASSETS

LIABILITIES

Current liabilities

Accounts payable	\$ 149,621
Salaries payable and related expenses	371,455
Accrued expenses	98,454
Deferred revenue	3,562
Current portion of long-term liabilities	<u>119,451</u>

Total current liabilities 742,543

Non-current portion of long-term obligations 15,538,538

Total liabilities 16,281,081

NET ASSETS

Invested in capital assets, net of related debt (14,566,549)

Restricted for

Capital projects	15,772,905
Debt Service	34,667
School-based activities	5,499

Unrestricted 383,840

Total net assets 1,630,362

Total liabilities and net assets \$ 17,911,443

The accompanying notes are an integral part of these financial statements.

Bellaire Public Schools

STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

Functions/Program	Expenses	Program Revenues			Net (Expense)/ Revenue and Changes in Net Assets Governmental Activities
		Charges For Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental activities					
Instruction	\$ 2,863,852	\$ -	\$ 314,532	\$ -	\$ (2,549,320)
Supporting Services	1,692,602	-	2,538	-	(1,690,064)
Food Service	127,916	73,844	59,460	-	5,388
Athletic	161,611	34,562	6,091	-	(120,958)
Other	102,462	-	-	-	(102,462)
Interest on long-term debt	6,725	-	-	-	(6,725)
Depreciation-unallocated	69,387	-	-	-	(69,387)
Total governmental activities	<u>\$ 5,024,555</u>	<u>\$ 108,406</u>	<u>\$ 382,621</u>	<u>\$ -</u>	<u>(4,533,528)</u>
General purpose revenues					
Property taxes					
Levied for general purposes					3,469,215
Levied for debt service					225,128
State school aid - unrestricted					574,259
Investment and other					<u>324,475</u>
Total general purpose revenue					<u>4,593,077</u>
Change in net assets					59,549
Net assets, beginning of year					<u>1,570,813</u>
Net assets, end of year					<u>\$ 1,630,362</u>

-5- The accompanying notes are an integral part of these financial statements.

Bellaire Public Schools

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2006

	General Fund	2006 Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
ASSETS				
Cash and cash equivalents	\$ 446,052	\$ 15,503,266	\$ 162,239	\$ 16,111,557
Investments	352,228	-	263,379	615,607
Due from other governments	151,042	-	1,172	152,214
Taxes receivable	13,902	-	2,739	16,641
Accounts receivable	3,351	-	3,078	6,429
Due from other funds	5,693	-	-	5,693
Inventory	3,592	-	2,575	6,167
	<u>975,860</u>	<u>15,503,266</u>	<u>435,182</u>	<u>16,914,308</u>
Total assets	\$ 975,860	\$ 15,503,266	\$ 435,182	\$ 16,914,308
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Accounts payable and accrued expenses	\$ 131,146	\$ 114,932	\$ -	\$ 246,078
Salaries payable and related expenses	371,455	-	-	371,455
Deferred revenue	807	-	2,755	3,562
Due to other funds	-	4,500	1,193	5,693
	<u>503,408</u>	<u>119,432</u>	<u>3,948</u>	<u>626,788</u>
Total liabilities	503,408	119,432	3,948	626,788
FUND BALANCES				
Reserved for debt retirement	-	-	36,664	36,664
Reserved for capital projects	-	15,383,834	389,071	15,772,905
Reserved for special purpose	111,200	-	-	111,200
Reserved for Food Service	-	-	5,388	5,388
Reserved for school-based activities	-	-	111	111
Unreserved and undesignated	-	-	-	-
Reported in General Fund	361,252	-	-	361,252
	<u>472,452</u>	<u>15,383,834</u>	<u>431,234</u>	<u>16,287,520</u>
Total fund balances	472,452	15,383,834	431,234	16,287,520
Total liabilities and fund balances	\$ 975,860	\$ 15,503,266	\$ 435,182	

Reconciliation of Governmental Fund Balances to District-Wide Government Activities Net Assets

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in governmental funds. The cost of the assets is \$3,448,111 and the accumulated depreciation is \$(2,501,649).

946,462

Long-term liabilities, including bonds payable, are not due and payable in the current period and, therefore, are not reported as liabilities in the funds. Long-term liabilities at year-end consist of:

Bonds payable	\$ (15,619,485)	
Accrued interest on bonds	(1,997)	
Unamortized bond issuance costs	106,474	
Accumulated leave liability	(89,664)	(15,604,672)

An Internal Service Fund is used by the district to charge the severance costs to the individual funds.

The assets and liabilities of the Internal Service Fund are included with governmental activities.

1,052

Total net assets - governmental activities

\$ 1,630,362

The accompanying notes are an integral part of these financial statements.

Bellaire Public Schools

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS

Year Ended June 30, 2006

	General Fund	2006 Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
Revenues				
Property taxes	\$ 3,529,008	\$ -	\$ 225,128	\$ 3,754,136
Interest	106,918	3,992	23,727	134,637
State revenues	770,516	-	13,926	784,442
Federal revenues	114,928	-	51,419	166,347
Other	186,991	-	116,323	303,314
	<u>4,708,361</u>	<u>3,992</u>	<u>430,523</u>	<u>5,142,876</u>
Total revenues				
Expenditures				
Instruction	2,855,458	-	-	2,855,458
Supporting Services	1,686,405	-	-	1,686,405
Food Service	-	-	127,916	127,916
Athletic	-	-	155,603	155,603
Other	46,965	54,797	-	101,762
Debt Service				
Principal	-	-	240,000	240,000
Interest	-	-	15,365	15,365
Other	-	-	700	700
Capital outlay	13,233	-	20,022	33,255
	<u>4,602,061</u>	<u>54,797</u>	<u>559,606</u>	<u>5,216,464</u>
Total expenditures				
REVENUES OVER (UNDER) EXPENDITURES	<u>106,300</u>	<u>(50,805)</u>	<u>(129,083)</u>	<u>(73,588)</u>
Other financing sources (uses)				
Operating transfers in	-	-	121,069	121,069
Operating transfers out	(121,069)	-	-	(121,069)
Proceeds from bonds	-	15,570,000	28,887	15,598,887
Bond issuance costs	-	(135,361)	-	(135,361)
	<u>(121,069)</u>	<u>15,434,639</u>	<u>149,956</u>	<u>15,463,526</u>
Total other financing sources (uses)				
REVENUE OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	<u>(14,769)</u>	<u>15,383,834</u>	<u>20,873</u>	<u>15,389,938</u>
Fund balance, beginning of year	487,221	-	410,361	897,582
Fund balance, end of year	<u>\$ 472,452</u>	<u>\$ 15,383,834</u>	<u>\$ 431,234</u>	<u>\$ 16,287,520</u>

The accompanying notes are an integral part of these financial statements.

Bellaire Public Schools

RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES WITH THE DISTRICT-WIDE STATEMENT OF ACTIVITIES

Year Ended June 30, 2006

Total Net Change in Fund Balances - Governmental Funds \$ 15,389,938

Amounts reported for governmental activities in the statement of activities are different because:

Capital outlays to purchase or build capital assets are reported in the governmental funds as expenditures. However, costs that meet the capitalization policy are shown in the statement of net assets and allocated over their estimated useful lives as annual depreciation expenses in the statement of activities. This is the amount by which depreciation exceed capital outlays in the period.

Depreciation expense (69,387)

In the statement of activities, certain operating expenses-compensated absences (vacations and sick leave) - are measured by the amounts earned during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually paid). This year, sick time earned was less than the amounts paid by \$12,656.

12,656

Repayment of bond principal is an expenditure in the governmental funds, but it reduces long-term liabilities in the statement of net assets and does not affect the statement of activities.

244,057

Bond proceeds are a financing source in the governmental funds, but are recorded as a liability in the statement of net assets.

(15,570,000)

Issuance costs are a reduction of bond proceeds in the governmental funds, but are amortized over the life of the bonds in the district-wide statements.

106,474

Revenue is recorded on the accrual method in the statement of activities; in the governmental funds it is recorded on the modified accrual method and not considered available. Therefore, associated are revenues deferred in the funds.

(59,793)

Interest on long-term debt in the statement of activities differs from the amount reported in the governmental funds because interest is recorded as an expenditure in the funds when it is due, and thus requires the use of current financial resources. In the statement of activities, however, interest expense is recognized as the interest accrues, regardless of when it is due. The interest reported in the statement of activities is the net result of the decrease in accrued interest on bonds payable.

4,583

An Internal Service Fund is used by the district to charge the severance costs to the individual funds. The net revenue of these activities is reported with governmental activities.

1,021

Changes in Net Assets of Governmental Activities

\$ 59,549

Bellaire Public Schools

STATEMENT OF NET ASSETS - INTERNAL SERVICE FUND

Year Ended June 30, 2006

ASSETS	
Cash and cash equivalents	<u><u>\$ 56,366</u></u>
LIABILITIES AND NET ASSETS	
LIABILITIES	
Early retirement incentive payable	\$ 55,314
NET ASSETS	
Unreserved, undesignated	<u>1,052</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 56,366</u></u>

The accompanying notes are an integral part of these financial statements.

Bellaire Public Schools

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS - INTERNAL SERVICE FUND

Year Ended June 30, 2006

OPERATING REVENUES

Charges to other funds	\$ 14,607
------------------------	-----------

OPERATING EXPENSES

Early retirement incentive	<u>14,607</u>
----------------------------	---------------

Operating income	-
------------------	---

NON-OPERATING REVENUES

Interest income	<u>1,021</u>
-----------------	--------------

Change in net assets	1,021
----------------------	-------

NET ASSETS - beginning of year	<u>31</u>
---------------------------------------	-----------

NET ASSETS - end of year	<u><u>\$ 1,052</u></u>
---------------------------------	------------------------

Bellaire Public Schools

STATEMENT OF CASH FLOWS - INTERNAL SERVICE FUND

June 30, 2006

CASH FLOWS FROM OPERATING ACTIVITIES

Received from charges to other funds	\$ 14,607
--------------------------------------	-----------

CASH FLOWS FROM INVESTING ACTIVITIES

Interest earned	<u>1,021</u>
-----------------	--------------

Net increase in cash and cash equivalents	15,628
---	--------

CASH AND CASH EQUIVALENTS - beginning of year	<u>40,738</u>
---	---------------

CASH AND CASH EQUIVALENTS - end of year	<u><u>\$ 56,366</u></u>
---	-------------------------

Reconciliation of operating income to net cash from Operating Activities:

Operating income	\$ -
------------------	------

Adjustments to reconcile operating income to net cash provided by

Operating Activities	
Increase in Early retirement incentive payable	<u>14,607</u>

Net cash provided by Operating Activities	<u><u>\$ 14,607</u></u>
---	-------------------------

Bellaire Public Schools

STATEMENT OF FIDUCIARY NET ASSETS

June 30, 2006

	<u>Agency Funds</u>
ASSETS	
Cash and cash equivalents	\$ 36,948
Accounts receivables	<u>897</u>
Total assets	<u><u>\$ 37,845</u></u>
LIABILITIES AND NET ASSETS	
Due to pupil activities	\$ 797
Due to student groups	<u>37,048</u>
Total liabilities and net assets	<u><u>\$ 37,845</u></u>

Bellaire Public Schools

NOTES TO FINANCIAL STATEMENTS

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Introduction

Bellaire Public Schools (the "School District") is a Michigan public school district consisting of an elementary school, a middle school and a high school. The School District primarily serves the Bellaire community. As of June 30, 2006, the School District employs 39 professional staff and 21 non-professional staff and has 562 students enrolled within its School District.

The accounting policies of the School District conform to generally accepted accounting principles as applicable to governments. The School District is considered to be a local government unit.

The accounting and reporting framework and the more significant accounting principles and practices of the School District are discussed in subsequent sections of this note. The remainder of the notes are organized to provide explanations, including required disclosures, of the School District's financial activities for the fiscal year ended June 30, 2006.

The Financial Reporting Entity

Bellaire Public Schools' Board of Education (the "Board") is the basic level of government which has oversight responsibility and control over all activities related to public school education. The Board receives funding from local, State and Federal government sources and must comply with the concomitant requirements of these funding source entities. However, the Board is not included in any other governmental "reporting entity," as defined in Governmental Accounting Standards Board ("GASB") statement No. 14, since Board members are elected by the public and have decision-making authority to levy taxes, the power to designate management, the ability to significantly influence operations and primary accountability for fiscal matters. In addition, under the criteria of the GASB pronouncement, student, parent and teacher organizations are not included, except to the extent that the School District holds assets in the capacity of an agent.

Government-Wide and Fund Financial Statements

Government-Wide Financial Statements

The statement of net assets and statement of activities display information about the School District as a whole, except for its fiduciary activities. Individual funds are not displayed but the statements distinguish governmental activities, generally supported by taxes and School District general revenues.

NOTES TO FINANCIAL STATEMENTS - Continued

The statement of activities reports the expenses of a given function offset by program revenues directly connected with the functional program. A function is an assembly of similar activities and may include portions of a fund or summarize more than one fund to capture the expenses and program revenues associated with a distinct functional activity. Program revenues include: (1) charges for services which report fees, fines and forfeitures, and other charges to users of the School District's services; (2) operating grants and contributions which finance annual operating activities including restricted investment income; and (3) capital grants and contributions which fund the acquisition, construction or rehabilitation of capital assets. These revenues are subject to externally imposed restrictions to these program uses. Taxes and other revenue sources not properly included with program revenues are reported as general revenues.

Fund Financial Statements

The balance sheet and statement of revenues, expenditures and changes in fund balances (i.e., fund financial statements) for the School District's governmental funds are presented after the government-wide statements. These statements display information about major funds individually and non-major funds in the aggregate for governmental funds. Major funds are generally those that represent 10% or more of governmental fund assets, liabilities, revenues or expenditures.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The financial statements of the School District are prepared in accordance with generally accepted accounting principles ("GAAP"). The School District's reporting entity applies all relevant Governmental Accounting Standards Board ("GASB") pronouncements and applicable Financial Accounting Standards Board ("FASB") pronouncements and Accounting Principles Board ("APB") opinions issued on or before November 30, 1989, unless they conflict with GASB pronouncements. The School District's reporting entity does not apply FASB pronouncements or APB opinions issued after November 30, 1989.

The government-wide statements report using the economic resource measurement focus and the accrual basis of accounting generally including the reclassification or elimination of internal activity (between or within funds). Reimbursements are reported as reductions to expenses. Proprietary and fiduciary fund financial statements also report using this same focus and basis of accounting, although internal activity is not eliminated in these statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized in the year for which they are levied while grants are recognized when grantor eligibility requirements are met.

Governmental fund financial statements report using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they are both measurable and available. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The School District considers revenues to be available if they are collected within 60 days of the end of the fiscal year. Expenditures are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported as expenditures in the year due.

Major revenue sources susceptible to accrual include property taxes, intergovernmental revenues and investment income. In general, other revenues are recognized when cash is received.

NOTES TO FINANCIAL STATEMENTS - Continued

When both restricted and unrestricted resources are available for use, it is the School District's policy to use restricted resources first, then unrestricted resources as needed.

Fund Types and Major Funds

Activities in Major Funds

The General Fund is the general operating fund of the School District. It is used to account for all financial resources except those required to be accounted for in another fund.

Other Governmental Funds

The School Service Funds are Special Revenue Funds that segregate, for administrative purposes, the transactions of a particular activity from regular revenue and expenditure accounts. The School District maintains full control of these funds. The Special Revenue Funds maintained by the School District are the Athletic Fund, the Food Service Fund, and the Daycare Fund.

The Debt Service Funds are used to account for the accumulation of resources for, and the payment of, bond principal, interest and related costs. The Debt Service Funds maintained by the School District are the 1999 Refunding Bond Fund and the 2006 School Building & Site Bond Fund.

The Capital Projects Fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities.

The Internal Service Fund is used to account for operations that provide services to other departments or agencies of the government.

Fiduciary Funds

Fiduciary Funds are used to account for assets held by the School District in a trustee capacity or as an agent. Fiduciary Fund net assets and results of operations are not included in the government-wide statements. Agency Funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations.

Cash and Equivalents

The School District's reporting entity considers highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents.

Investments

Investments are stated at market value.

Inventories

Inventories in governmental funds consist of expendable supplies held for consumption stated on a first-in, first-out basis. They are reported at cost, which is recorded as an expenditure at the time individual inventory items are used.

NOTES TO FINANCIAL STATEMENTS - Continued

Capital Assets

Capital assets are recorded at cost or, if donated, the fair value at the time of donation. Capital assets are depreciated over their estimated useful lives ranging from 5 to 50 years. The School District generally capitalizes assets with costs of \$5,000 or more as purchase and construction outlays occur. No depreciation is recorded on land or construction-in-process. Expenditures for major renewals and betterments that extend the useful lives of the capital assets are capitalized. Expenditures for maintenance and repairs are charged to current expenditures as incurred. Depreciation is computed using the straight-line method. When capital assets are disposed, the cost and applicable accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recorded in operations.

Estimated useful lives, in years, for depreciable assets are as follows:

Buildings	50 years
Improvements, other than buildings	20 years
Buses and vehicles	10 years
Furniture and equipment	5 years

Long-term Debt, Deferred Debt Expense and Bond Discounts/Premiums

In the government-wide financial statements, outstanding debt is reported as liabilities. Bond issuance costs, bond discounts or premiums, and the difference between the reacquisition price and the net carrying value of refunded debt are capitalized and amortized over the terms of the respective bonds using a method that approximates the interest method.

The governmental fund financial statements recognize the proceeds of debt and premiums as other financing sources of the current period. Issuance costs are reported as expenditures.

Fund Equity

The governmental fund financial statements report reserved fund balance for amounts not available for appropriation or legally restricted for specified purposes. Designations of fund balance represent tentative management plans that are subject to change.

Program Revenues

Program revenues derive directly from the program itself or from outside parties for the restricted use in a particular program. On the statement of activities, program revenues reduce the net cost of the various functions to reflect the amount which is financed from the School District's general revenues.

The School District's most significant program revenues are Title I, At-Risk and School Lunch Program, which are reported as operating grants and contributions.

Spending Policy

The School District's policy is to apply restricted revenues first when an expense is incurred for purposes when both restricted and unrestricted net assets are available.

NOTES TO FINANCIAL STATEMENTS - Continued

Encumbrance Accounting

The School District formally records encumbrances in the accounting records during the year as a normal practice. In accordance with generally accepted accounting principles, outstanding encumbrances at year-end for which goods or services are received are reclassified as expenditures and accounts payable. All other encumbrances in the annual budgeted funds are reversed at year-end and are either canceled or are included as reappropriations of fund balance for the subsequent year.

Allocation of Expenses

The School District reports each function's direct expenses, those that are specifically associated with a service, program or department and, thus, are clearly identifiable to a particular function.

The School District has elected to not allocate indirect expenses.

Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

NOTE B - BUDGETARY POLICY AND PRACTICE

The School District has adopted these procedures in establishing the budgets as reflected in the financial statements.

1. As early as possible in the preceding fiscal year (generally in the spring), the Superintendent formulates preliminary budgets for the coming year, which he submits to the Board of Education for their review.
2. A public hearing is held prior to June 30 on the proposed budgets to obtain taxpayer comments.
3. The Board of Education reviews the proposed budget and then in June adopts a formal resolution approving the needed appropriations for the coming operating year.
4. All transfers of budget amounts and any amendments to the formal Appropriation Act are approved by the Board of Education.
5. It is the Superintendent's responsibility to supervise and monitor the budget process. He does this by reviewing the monthly financial data and reporting and recommending any needed amendments to the Board of Education.
6. The budget is adopted on a basis consistent with generally accepted accounting principles.
7. The budgets presented in these financial statements are as originally adopted and as formally amended by the Board of Education.
8. All annual appropriations lapse at fiscal year-end.

NOTES TO FINANCIAL STATEMENTS - Continued

Excess of Expenditures over Appropriations in Budgeted Funds

Michigan Public Act 621 of 1978 provides that a local unit shall not incur expenditures in excess of the amounts appropriated. During the year ended June 30, 2006, the School District was out of compliance with the Act as follows:

	<u>Budget</u>	<u>Actual</u>	<u>Variance</u>
General Fund			
Other	<u>\$ 42,030</u>	<u>\$ 46,965</u>	<u>\$ (4,935)</u>

NOTE C - CASH AND INVESTMENTS

At June 30, 2006, the School District's cash and investments include the following:

	<u>Balance Sheet Classification</u>		
	<u>Cash and Equivalents</u>	<u>Investments</u>	<u>Total</u>
Cash on hand	\$ 75	\$ -	\$ 75
Bank deposits	214,170	-	214,170
Investments	<u>15,990,626</u>	<u>615,607</u>	<u>16,606,233</u>
	<u>\$ 16,204,871</u>	<u>\$ 615,607</u>	<u>\$ 16,820,478</u>

Bank Deposits

	<u>Carrying Value</u>	<u>Uncollateralized Bank Balances</u>		
		<u>Insured</u>	<u>Uninsured</u>	<u>Total</u>
Bank deposits	<u>\$ 214,170</u>	<u>\$ 149,376</u>	<u>\$ 72,686</u>	<u>\$ 222,062</u>

All of the School District's bank deposits are with financial institutions which provide FDIC insurance coverage.

Investments

The School District's investment policy permits investments in the following vehicles:

1. Bonds, bills or notes of the United States; obligations, the principal and interest of which are fully guaranteed by the United States or the State of Michigan.
2. Certificates of deposit issued by financial institutions organized and authorized to operate in Michigan.
3. Commercial paper rated prime 1 or prime 2 at the time of purchase and maturing not more than 270 days after the date of purchase.

NOTES TO FINANCIAL STATEMENTS - Continued

4. Securities issued or guaranteed by agencies or instrumentalities of the United States government or Federal agency obligation repurchase agreements, and bankers' acceptance issued by a bank that is a member of the Federal deposit insurance corporation.
5. Mutual funds composed entirely of investment vehicles that are legal for direct investment by a school district.
6. Michigan Investment Liquid Asset Fund Plus ("MILAF").

Investments at June 30, 2006 consisted of the following:

Investment Type	Fair Value	Investment Maturities (in years)			
		Current	1-5	6-10	More than 10
Certificate of Deposits	\$ 615,607	\$ 615,607	\$ -	\$ -	\$ -
MILAF	<u>15,990,626</u>	<u>15,990,626</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$16,606,233</u>	<u>\$16,606,233</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

In accordance with the School District's investment policy, the School District will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fail due to changes in market interest rates, by: structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in short-term securities, or MILAF and limiting the average maturity in accordance with the School District's cash requirements.

Credit Risk

State law limits investments in commercial paper and corporate bonds to a prime or better rating issued by nationally recognized rating organizations. The School District's investment policy further limit it's investment choices as described above. The School District's investment in the MILAF investment pool was rated AAAM by Standard & Poor's.

NOTE D - RECEIVABLES, UNCOLLECTIBLE ACCOUNTS AND DEFERRED REVENUE

Property Taxes Receivable, Deferred Revenue and Property Tax Calendar

Property taxes are levied, billed and attached as enforceable liens in July and December of the School District's fiscal year. Townships within the School District collect and remit taxes until February 15, at which time the uncollected real property taxes are turned over to the counties as delinquent. Delinquent real property taxes are funded by the county and remitted to the School District. Delinquent personal property tax remains a receivable until collected from the taxpayer by the townships and remitted to the School District. In the governmental fund financial statements, if delinquent taxes are not paid within 60 days of year-end, they are recorded as deferred revenue. In the government-wide financial statements, property taxes receivable and related revenue include all amounts due the School District regardless of when cash is received. Over time, substantially all property taxes are collected.

NOTES TO FINANCIAL STATEMENTS - Continued

During the fiscal year, \$18 per \$1,000 of equalized non-homestead property value of \$196 million was levied for general operating purposes. For debt service purposes, \$0.70 per \$1,000 of equalized homestead and non-homestead property value of \$322 million was levied for bonded debt repayments by the Debt Service Fund.

Intergovernmental Receivables and Deferred Revenue

Intergovernmental receivables are primarily comprised of amounts due from the State and Federal governments. Revenue is recorded as earned when eligibility requirements are met. Grant revenues deferred in the governmental fund financial statements include unearned revenue and revenue received more than 60 days following year-end (unavailable to pay liabilities of the current period). Deferred revenue received after 60 days is fully recognized as revenue in the government-wide statements if grantor eligibility requirements are met.

Amounts due from other governments at June 30, 2006 are as follows:

Due from the State of Michigan	
State Aid	\$ 139,712
Due from Federal grants	<u>12,502</u>
	<u><u>\$ 152,214</u></u>

NOTE E - INVESTMENTS IN CAPITAL ASSETS

Investments in capital assets consist of the following:

	<u>June 30, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>June 30, 2006</u>
Land improvements	\$ 469,387	\$ -	\$ -	\$ 469,387
Buildings and improvements	2,219,418	-	-	2,219,418
Furniture and equipment	227,285	-	-	227,285
Buses and vehicles	<u>531,109</u>	<u>-</u>	<u>-</u>	<u>531,109</u>
Total depreciable assets	3,447,199	-	-	3,447,199
Less accumulated depreciation	(2,432,262)	(69,387)	-	(2,501,649)
Land	<u>912</u>	<u>-</u>	<u>-</u>	<u>912</u>
Total capital assets, net	<u><u>\$ 1,015,849</u></u>	<u><u>\$ (69,387)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 946,462</u></u>

Depreciation expense was charged to the function in the statement of activities, as follows:

Unallocated	<u><u>\$ 69,387</u></u>
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NOTES TO FINANCIAL STATEMENTS - Continued

NOTE F - LONG-TERM LIABILITIES

Changes in long-term debt during the year ended June 30, 2006 were as follows:

	<u>Beginning Balance</u>	<u>New Debt</u>	<u>Payments</u>	<u>Ending Balance</u>	<u>Current Portion</u>
General obligation bonds	\$ 293,542	\$ 15,570,000	\$ 244,057	\$ 15,619,485	\$ 124,249
Accumulated leave liability	102,320	-	12,656	89,664	-
Early retirement incentive	40,707	14,607	-	55,314	-
Unamortized bond issuance costs/premium	<u>-</u>	<u>(106,474)</u>	<u>-</u>	<u>(106,474)</u>	<u>(4,798)</u>
Long-term debt at June 30, 2006	<u>\$ 436,569</u>	<u>\$ 15,478,133</u>	<u>\$ 256,713</u>	<u>\$ 15,657,989</u>	<u>\$ 119,451</u>

Payments on general obligation bonds are made by the Debt Service Fund. The accumulated leave liability will be liquidated primarily by the General Fund.

At June 30, 2006, the School District's long-term debt consisted of the following:

2006 Building and Site Bonds; due in annual installments of \$709,594 to \$1,158,100 through May 2036; interest rate of 4% to 5.125%. \$15,570,000

1998 School Improvement Bond (Durant); due in installments of \$5,884 to \$27,772 through May 15, 2013; average interest rate of 4.76%. This debt will be repaid using revenues provided by the State of Michigan specifically for this purpose. If the Michigan Legislature fails to appropriate funds, the School District is not liable for repayment of these bonds. 49,485

Total general obligation bonds payable 15,619,485

Unamortized bond issuance costs/premium (106,474)

Accumulated leave liability 89,664

Early retirement incentive 55,314

Total long-term debt \$15,657,989

NOTES TO FINANCIAL STATEMENTS - Continued

Total annual requirements to amortize bonds outstanding as of June 30, 2006 are as follows:

<u>Years Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 124,249	\$ 600,885
2008	124,452	710,971
2009	164,664	705,959
2010	204,886	699,337
2011	250,119	691,104
2012-2016	1,881,115	3,268,617
2017-2021	2,970,000	2,755,975
2022-2026	3,250,000	2,050,219
2027-2031	3,275,000	1,309,219
2032-2036	<u>3,375,000</u>	<u>518,906</u>
	<u><u>\$ 15,619,485</u></u>	<u><u>\$ 13,311,192</u></u>

Interest expense for the year ended June 30, 2006 was \$6,725.

Accumulated Leave Liability

Employees of the School District accumulate days of compensated sick leave to one hundred-thirty days, as specified by the bargaining units' contract. This benefit vests after 10 years of employment. Upon either resignation or retirement, the employees are compensated at one-fourth daily rates specified in the bargaining units' contracts, up to \$3,400.

Early Retirement Incentives

Certain employees of the School District, hired prior to July 1, 2004, who have no less than 6 consecutive years of service and qualify under MPSERS, have the option, after completion of their contract, to be granted an early retirement incentive. The retiring member is entitled to a one-time payment of a sum of money equivalent to 25% of the annual teaching salary received during the year preceding retirement.

Durant Settlement

As a result of the Durant v State of Michigan settlement regarding State underfunding of school revenues, the School District will be receiving \$8,381 per year over a ten-year period beginning November 15, 1998. This represents 50% of the expected funds. For the remaining 50% of the funds from this settlement, or \$83,807, the School District has opted to participate in a bonding program enabling it to receive a lump-sum payment on November 15, 1998. The debt will be repaid over a 15-year period beginning May 15, 1999 using revenues provided by the State specifically for this purpose.

As part of the Executive Budget Recommendation for fiscal year 2004, the State refunded the bonds. The refunding changes the payment schedule without changing the total payments. There were no debt service payments for fiscal years 2004 and 2005, and payments resumed in 2006.

NOTES TO FINANCIAL STATEMENTS - Continued

NOTE G - RISK MANAGEMENT

The School District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; unemployment benefits; and natural disasters. The School District manages its risk exposures and provides certain employee benefits through a combination of self-insurance and risk management pools.

The School District participates in two distinct pools of educational institutions within the State of Michigan for self-insuring property and casualty and workers' disability compensation. The pools are considered public entity risk pools. The School District pays annual premiums to each pool for the respective insurance coverage. In the event a pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. Each of the pools maintain reinsurance for claims in excess of \$500,000 for each occurrence with the overall maximum coverage being unlimited. The School District has not been informed of any special assessments being required for the current year or prior three years.

The School District continues to carry commercial insurance for other risks of loss, including employee health and accident insurance.

NOTE H - BALANCES AND TRANSFERS/PAYMENTS WITHIN THE REPORTING ENTITY

Receivables and Payables

Outstanding balances between funds reported as "due to/from other funds" include outstanding charges by one fund to another for services or goods, subsidy commitments outstanding at year-end and other miscellaneous receivables/payables between funds.

Fund	Interfund Receivable	Interfund Payable
General Fund	\$ 5,693	\$ -
2006 Capital Projects Fund	-	4,500
Other Governmental Funds	-	1,193
	<u>\$ 5,693</u>	<u>\$ 5,693</u>

Transfers and Payments

Transfers and payments within the reporting entity are substantially for the purposes of subsidizing operating functions, funding capital projects and asset acquisitions or maintaining debt service on a routine basis. Resources are accumulated in a fund to support and simplify the administration of various projects or programs.

The government-wide statement of activities eliminates transfers as reported within the segregated governmental and business-type activities columns. Only transfers between the two columns appear in this statement.

NOTES TO FINANCIAL STATEMENTS - Continued

The following schedule reports transfers and payments within the reporting entity:

<u>Transfer in</u>	<u>Amount</u>	<u>Transfer out</u>	<u>Amount</u>
Other Governmental Funds		Major Governmental Funds	
Athletic Fund	<u>\$ 121,069</u>	General Fund	<u>\$ 121,069</u>

NOTE I - PENSION PLAN

The School District contributes to the Michigan Public School Employees' Retirement Systems ("MPERS"), a cost-sharing multiple-employer defined benefit pension plan administered by the State of Michigan, Department of Management & Budget ("DMB"). MPERS provides retirement, disability, death and post-employment health benefits to plan members and beneficiaries. Member Investment Plan ("MIP") participants receive enhanced benefits compared to Basic Plan participants. Benefits are safeguarded by Article IX, Section 24 of the Michigan Constitution. Public Act 300 of 1980, as amended, assigns authority to establish and amend benefit provisions to the State Legislature. MPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to MPERS, P.O. Box 30171, Lansing, MI 48909-7671, or by calling (517) 322-5103 or on the State of Michigan's website at www.Michigan.gov.

Funding Policy

Plan members who participate in MIP are required to contribute 3% to 4.3% of their annual covered salary; plan members who participate in the Basic Plan may not contribute to the Plan; and Bellaire Public Schools is required to contribute at an actuarially determined rate. The rate was 14.87% for the period July 1, 2005 to September 30, 2005 and 16.34% for the period October 1, 2005 to June 30, 2006 of annual covered payroll. The contribution requirements of plan members and the School District are established and may be amended by the State Legislature. The School District's contributions to MPERS for the years ended June 30, 2006, 2005 and 2004 were \$407,285, \$403,226 and \$389,534, respectively, which is equal to the required contribution for each year.

Basic Plan members make no contributions. For a limited period ending December 31, 1992, an active Basic Plan member could enroll in the MIP by paying the contributions that would have been made had enrollment occurred initially on January 1, 1987 or on the date of hire, plus interest. MIP contributions at the rate of 3.9% of gross wages begin at enrollment. Market rate interest is posted to member accounts on July 1st on all MIP monies on deposit for 12 month. If a member leaves MPERS service and no pension is payable, the member's accumulated contribution plus interest, if any, are refundable.

NOTE J - COMMITMENTS AND CONTINGENCIES

Construction Commitment

The 2006 Capital Projects Fund accounts for activity related to the erecting, furnishing and equipping additions to and partially remodeling, furnishing and refurbishing, equipping and re-equipping school facilities; acquiring, installing and equipping technology for school facilities; developing and improving the sites; and paying the costs of issuing the related bonds. For this capital project, the School District has complied with the applicable provisions of Section 1351a of the Revised School Code.

As of June 30, 2006, the School District has committed to a total project cost of \$15,570,000, of which \$190,158 has been expended to date, leaving a remaining construction commitment of \$15,379,842. The Capital Projects Fund balance was \$15,383,834 at June 30, 2006.

Federal and State Grants

In the normal course of operations, the School District receives grant funds from various Federal and State agencies. The grant programs are subject to audit by agents of the granting authorities, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as the result of these audits is not believed to be material.

Collectively Bargained Employment Agreements

The teachers of the School District are organized under the Northern Michigan Education Association. The Bellaire Public Schools and the Northern Michigan Education Association have a contract for the years ending June 30, 2005 through June 30, 2007.

The Support and Food Service personnel at the School District are organized under the Bellaire Educational Support Professional Association. The Board of Education and the Bellaire Educational Support Professional Association have a contract for August 31, 2003 through August 31, 2007.

REQUIRED SUPPLEMENTARY INFORMATION

Bellaire Public Schools

BUDGETARY COMPARISON SCHEDULE FOR THE GENERAL FUND

Year Ended June 30, 2006

	Budgeted Amounts		Actual (GAAP Basis)	Variances - Positive (Negative)	
	Original	Final		Original to Final	Final to Actual Total
Revenues					
Local sources	\$ 3,623,604	\$ 3,641,983	\$ 3,635,926	\$ 18,379	\$ (6,057)
State revenues	720,384	770,715	770,516	50,331	(199)
Federal revenues	121,700	112,865	114,928	(8,835)	2,063
Other	<u>111,247</u>	<u>193,282</u>	<u>186,991</u>	<u>82,035</u>	<u>(6,291)</u>
Total revenues	<u>4,576,935</u>	<u>4,718,845</u>	<u>4,708,361</u>	<u>141,910</u>	<u>(10,484)</u>
Expenditures					
Instruction	2,807,125	2,904,186	2,862,494	(97,061)	41,692
Supporting Services	1,683,432	1,729,726	1,692,602	(46,294)	37,124
Other	<u>71,926</u>	<u>42,030</u>	<u>46,965</u>	<u>29,896</u>	<u>(4,935)</u>
Total expenditures	<u>4,562,483</u>	<u>4,675,942</u>	<u>4,602,061</u>	<u>(113,459)</u>	<u>73,881</u>
REVENUES OVER EXPENDITURES	14,452	42,903	106,300	28,451	63,397
Other financing sources (uses)					
Operating transfers out	<u>(132,036)</u>	<u>(132,140)</u>	<u>(121,069)</u>	<u>(104)</u>	<u>11,071</u>
REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	(117,584)	(89,237)	(14,769)	28,347	74,468
Fund balance, beginning of year	<u>487,221</u>	<u>487,221</u>	<u>487,221</u>	<u>-</u>	<u>-</u>
Fund balance, end of year	<u><u>\$ 369,637</u></u>	<u><u>\$ 397,984</u></u>	<u><u>\$ 472,452</u></u>	<u><u>\$ 28,347</u></u>	<u><u>\$ 74,468</u></u>

**COMBINING FINANCIAL STATEMENTS OF
NON-MAJOR GOVERNMENTAL FUNDS**

Bellaire Public Schools

COMBINING BALANCE SHEET - NON-MAJOR GOVERNMENTAL FUNDS

June 30, 2006

	<u>Special Revenue Funds</u>		<u>Debt Service Funds</u>		<u>Capital Projects Fund</u>	<u>Total Non-Major Governmental Funds</u>
	<u>Food Service</u>	<u>Athletic</u>	<u>1999 Refunding Bond</u>	<u>2006 School Bldg & Site Bond</u>		
ASSETS						
Cash and cash equivalents	\$ 1,647	\$ 111	\$ 7,785	\$ 28,895	\$ 123,801	\$ 162,239
Investments	-	-	-	-	263,379	263,379
Due from other governments	1,172	-	-	-	-	1,172
Interest receivable	-	-	-	-	3,078	3,078
Taxes receivable	-	-	2,739	-	-	2,739
Inventory	<u>2,575</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>2,575</u>
Total assets	<u>\$ 5,394</u>	<u>\$ 111</u>	<u>\$ 10,524</u>	<u>\$ 28,895</u>	<u>\$ 390,258</u>	<u>\$ 435,182</u>
LIABILITIES AND FUND BALANCES						
LIABILITIES						
Deferred revenue	\$ -	\$ -	\$ 2,755	\$ -	\$ -	\$ 2,755
Due to other funds	<u>6</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,187</u>	<u>1,193</u>
Total liabilities	<u>6</u>	<u>-</u>	<u>2,755</u>	<u>-</u>	<u>1,187</u>	<u>3,948</u>
FUND BALANCES						
Reserved for debt retirement	-	-	7,769	28,895	-	36,664
Reserved for school-based activities	5,388	111	-	-	-	5,499
Reserved for capital projects	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>389,071</u>	<u>389,071</u>
Total fund balances	<u>5,388</u>	<u>111</u>	<u>7,769</u>	<u>28,895</u>	<u>389,071</u>	<u>431,234</u>
Total liabilities and fund balances	<u>\$ 5,394</u>	<u>\$ 111</u>	<u>\$ 10,524</u>	<u>\$ 28,895</u>	<u>\$ 390,258</u>	<u>\$ 435,182</u>

Bellaire Public Schools

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS

Year Ended June 30, 2006

	Special Revenue Funds		Debt Service Funds		Capital Projects Fund	Total Non-Major Governmental Funds
	Food Service	Athletic	1999 Refunding Bond	2006 School Bldg & Site Bond		
Revenues						
Property taxes	\$ -	\$ -	\$ 225,128	\$ -	\$ -	\$ 225,128
Interest	-	-	7,722	8	15,997	23,727
State revenues	8,041	-	5,885	-	-	13,926
Federal revenues	51,419	-	-	-	-	51,419
Other	73,844	40,653	1,826	-	-	116,323
Total revenues	133,304	40,653	240,561	8	15,997	430,523
Expenditures						
Food Service	127,916	-	-	-	-	127,916
Athletic	-	155,603	-	-	-	155,603
Debt Service						
Principal	-	-	240,000	-	-	240,000
Interest	-	-	15,365	-	-	15,365
Other	-	-	700	-	-	700
Capital outlay	-	6,008	-	-	14,014	20,022
Total expenditures	127,916	161,611	256,065	-	14,014	559,606
REVENUES OVER EXPENDITURES	5,388	(120,958)	(15,504)	8	1,983	(129,083)
Other financing sources (uses)						
Operating transfers in	-	121,069	-	-	-	121,069
Proceeds from bond issue	-	-	-	28,887	-	28,887
Total other financing sources (uses)	-	121,069	-	28,887	-	149,956
REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	5,388	111	(15,504)	28,895	1,983	20,873
Fund balance, beginning of year	-	-	23,273	-	387,088	410,361
Fund balance, end of year	\$ 5,388	\$ 111	\$ 7,769	\$ 28,895	\$ 389,071	\$ 431,234

Bellaire Public Schools

COMBINING BALANCE SHEET - NON-MAJOR GOVERNMENTAL FUNDS

June 30, 2005

	<u>Special Revenue Funds</u>					Total Non-Major Governmental Funds
	<u>Food Service</u>	<u>Athletic</u>	<u>Day Care</u>	<u>1999 Refunding Bond</u>	<u>Capital Projects Fund</u>	
ASSETS						
Cash and cash equivalents	\$ 50	\$ 150	\$ 1,048	\$ -	\$ 384,713	\$ 385,961
Investments	-	-	-	23,573	2,375	25,948
Due from other governments	1,269	-	-	-	-	1,269
Accounts receivable	-	-	201	-	-	201
Taxes receivable	-	-	-	2,755	-	2,755
Due from other funds	-	524	-	-	-	524
Inventory	<u>1,679</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,679</u>
Total assets	<u>\$ 2,998</u>	<u>\$ 674</u>	<u>\$ 1,249</u>	<u>\$ 26,328</u>	<u>\$ 387,088</u>	<u>\$ 418,337</u>
LIABILITIES AND FUND BALANCES						
LIABILITIES						
Accounts payable	\$ -	\$ 674	\$ -	\$ 300	\$ -	\$ 974
Deferred revenue	-	-	-	2,755	-	2,755
Due to other funds	<u>2,998</u>	<u>-</u>	<u>1,249</u>	<u>-</u>	<u>-</u>	<u>4,247</u>
Total liabilities	2,998	674	1,249	3,055	-	7,976
FUND BALANCES						
Reserved for debt retirement	-	-	-	23,273	-	23,273
Reserved for capital projects	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>387,088</u>	<u>387,088</u>
Total liabilities and fund balances	<u>\$ 2,998</u>	<u>\$ 674</u>	<u>\$ 1,249</u>	<u>\$ 26,328</u>	<u>\$ 387,088</u>	<u>\$ 418,337</u>

Bellaire Public Schools

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS

Year Ended June 30, 2005

	Special Revenue Funds				1999 Refunding Bond	Capital Projects Fund	Total Non-Major Governmental Funds
	Food Service	Athletic	Day Care	Total			
Revenues							
Property Taxes	\$ 68,707	\$ 37,210	\$ -	\$ 105,917	\$ 258,240	\$ -	\$ 364,157
Interest	-	-	-	-	4,907	9,105	14,012
State revenues	9,066	-	-	9,066	48	-	9,114
Federal revenues	40,780	-	-	40,780	-	-	40,780
Total revenues	118,553	37,210	-	155,763	263,195	9,105	428,063
Expenditures							
Food Service	127,610	-	-	127,610	-	-	127,610
Athletic	-	153,555	-	153,555	-	-	153,555
Debt Service							
Principal	-	-	-	-	250,000	-	250,000
Interest	-	-	-	-	19,105	-	19,105
Other	-	-	-	-	2,082	-	2,082
Capital outlay	-	-	-	-	-	115,794	115,794
Total expenditures	127,610	153,555	-	281,165	271,187	115,794	668,146
REVENUES OVER EXPENDITURES	(9,057)	(116,345)	-	(125,402)	(7,992)	(106,689)	(240,083)
Other financing sources (uses)							
Operating transfers in	9,057	116,345	-	125,402	-	-	125,402
REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	-	-	-	-	(7,992)	(106,689)	(114,681)
Fund balance, beginning of year	-	-	-	-	31,265	493,777	525,042
Fund balance, end of year	\$ -	\$ -	\$ -	\$ -	\$ 23,273	\$ 387,088	\$ 410,361



DENNIS, GARTLAND & NIERGARTH P.C.

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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Education
Bellaire Public Schools

We have audited the financial statements of the governmental activities, each major fund and the aggregate remaining fund information of **Bellaire Public Schools** (the "School District") as of and for the year ended June 30, 2006, which collectively comprise the School District's basic financial statements and have issued our report thereon dated July 27, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Education, management, Michigan Department of Education, Federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Dennis, Gartland & Niergarth

July 27, 2006



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AUDIT-RELATED COMMUNICATIONS

To the Board of Education
Bellaire Public Schools

We have audited the financial statements of Bellaire Public Schools (the "School District") for the year ended June 30, 2006, and have issued our report thereon dated July 27, 2006. Professional standards require that we provide you with the following information related to our audit:

Our Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated June 26, 2006, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of Bellaire Public Schools. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

We remind you that an inherent weakness in your system of internal control exists because the limited size of your staff does not permit an adequate segregation of duties. Without an adequate segregation of duties, there is an increased risk that errors or fraud could occur and not be detected. We can provide consulting services to help you identify your greatest risk exposures and design procedures to reduce those risks to the extent reasonably possible.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Bellaire Public Schools are described in Note A to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2006. We noted no transactions entered into by Bellaire Public Schools during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Debt Service and Capital Projects Fund Budgets

During the current year audit, we noted the Board of Education adopted budgets for the Debt Service and Capital Projects Funds. The adoption of these budgets are no longer required by the State. We recommend preparing these budgets for internal management and guidance purposes only, not for adoption by the Board of Education.

Agency Funds

The High School Student Activities Fund, within the Bellaire Public Schools Agency Funds should be reconciled on a monthly basis. Additionally, supporting documentation should be received prior to issuing reimbursement checks from the account. We recommend the School District review its policies and procedures related to the Agency Funds to insure that these funds are accounted for properly and balanced prior to the beginning of the annual audit.

Procedures for Approving Disbursements

During the current year audit, we reviewed the disbursement approval process. We recommend the Superintendent be provided with a weekly or bi-weekly manifest of bills to be paid. This listing can also be included with the monthly Board packets, in preparation for the monthly Board meetings. The implementation of this procedure will allow for another layer of segregation of duties.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. During the audit, we evaluated management's estimates against available information as a basis for concluding about the reasonableness of these estimates. However, we do not consider such estimates to be particularly sensitive.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the School District's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the School District, either individually or in the aggregate, indicate matters that could have a significant effect on the School District's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the School District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

General Comments and Considerations

Time and Effort Reporting Requirements

The recently published Michigan Department of Education Accounting and Auditing alert highlights the importance of proper time and effort reporting in relation to Federal programs. We recommend that the School District and Board review these requirements and that your internal documentation requirements be reviewed for compliance with OMB Circular A-87. Proper documentation will help prevent any future potential charge-backs for Federal funds.

Budget Deficits and the Uniform Budgeting and Accounting Act

The Michigan Department of Education has recently issued several districts letters which appear to be in violation of the Uniform Budgeting and Accounting Act. This act requires that school districts not operate with a deficit budget. In the extreme case, the Attorney General could take action against a school and its board members were a deficit budget to be enacted. This issue is being monitored by the Department of Education, and correspondence will be issued when violations of the act are detected.

Hay Group Report on the Michigan Public School Health System

A recently released report by the Hay Group gives the opinion that approximately \$280 million could be saved if Michigan were to abandon its Michigan Educational Special Services Association ("MESSA") health coverage and implement a state-wide health benefit system for public school employees. All organizations will face issues with funding health care coverage in the future and schools will be especially hard hit because school funding is not increasing at a pace to offset projected medical cost increases. MESSA has commissioned a study by Reden & Anders Ltd. to analyze the Hay Group report and determine if the projected savings are real. This report was recently released and points out some concerns with the methodology. There is currently legislation pending regarding this issue.

The 65% Solution

The 65% solution is a school spending philosophy that has taken hold recently in a number of states. The basic premise of the philosophy is that by requiring a school to spend 65% or more of a district's budget directly in the classroom, school performance will improve and excessive overhead costs will be squeezed out. Proponents of this program site statistics that show the top performing schools spend over 64% of their budgets directly in the classroom, while the lowest performing schools spend as little as 49% in the classroom. Opponents to the philosophy say it depends on how you measure and what is considered as classroom spending. Opponents also say it is backed mostly by voucher and charter school supporters as a tactic to help voucher legislation get passed in more states. Legislation has been passed in 2 states regarding this and 10 others have some sort of proposal in process.

MSBO Conference Raises “Red Flag” on Athletic, Student Activity, School Lunch and Other Internal Control Risks

At this Spring's MSBO conference, one of the “red-flags” raised was the lack of proper internal controls around cash intensive areas of a school district, such as athletic tickets and school lunch. As published in regional newspapers, a school district in the Northern Michigan region was recently an unfortunate victim of a \$100,000 embezzlement incident in the school lunch area. Unfortunately, a financial audit does little to provide assurance that your school district has proper procedures in place for these and other high-risk areas.

A school district needs to conduct an ongoing evaluation of its internal controls in all areas to limit its exposure. Internal controls are the policies and procedures you put in place to reduce the potential for undetected mistakes or fraud. Like most small organizations, your internal control system is inherently weakened by the absence of an adequate segregation of incompatible duties (one or a few people do everything). Everybody can make mistakes and most frauds are perpetrated by people held in a position of trust so this is an issue regardless of the qualities of the people working for you.

Internal controls are designed both to protect you from corrupt employees, customers, vendors and others and to protect honest employees from innocent mistakes and misplaced suspicions. There may be opportunities for you to reduce the risk of undetected mistakes or fraud through the implementation of a few relatively easy internal control procedures. We would be happy to work with you to identify your greatest risk exposures and offer suggestions for ways to reduce that risk with simple cost-effective procedures.

The Importance of Long-Term Planning

Recent financial issues in school districts throughout the State highlight the increased need for long-term school planning. Minimal increases in the foundation allowance along with increasing health care and retirement costs will only make the future more difficult to manage. A long-term (5 year) plan is one means for a school district to proactively manage their financial future. This is a depressing exercise in today's environment, but one that is critical for the Board to analyze the impact of various scenarios on the school's future. If you have not already done so, you should consider this process. To be most effective, this should be a group process and updated on an annual basis. These projections will be useful when undergoing contract negotiations.

Budget Fund Balance

State law mandates that districts do not operate with a deficit budget. State law does not, however, mandate maintaining a healthy fund balance. Maintaining a minimum fund balance is only smart management of the district's resources. We believe a fund balance of approximately 15% of the total annual operation expense of the School District's General Fund Budget is a good target fund balance. Setting a target fund balance to maintain would provide flexibility in dealing with unanticipated budget emergencies such as mid-year reductions in State funding. We recommend the School District discuss a target fund balance and adopt a Board policy, this will provide guidance and direction on an annual basis as each year's operating budget is prepared and adopted.

Headlee Rollback

Under Proposal A, districts receive a foundation allowance multiplied by the number of students. The foundation allowance is paid from two sources, property taxes and the State. The 18 mills approved by voters in 1996 for non-homestead property is the portion determined to come from property taxes. When property is sold and re-valued at a level much higher than the rate of inflation, it can cause the 18 mills to be rolled back. The State does not pick up this difference in reduction of mills. To get the full per student operational dollars that the State authorized under Proposal A, districts may find it necessary to hold an override vote to restore the full 18 mills. Headlee Rollback reduces the authorized millage rate, not the levied rate. So, districts with high growth may find it necessary to hold an override vote annually if only the 18 mills are requested. Such districts might find it appropriate to request authorization of 20 to 21 mills. Since State law prohibits districts from levying more than 18 mills, there is no downside to authorizing more than the needed 18 mills. Then, if a rollback occurs, it is applied to the 20 or 21 mills, not the 18 mills levied. This would eliminate the need to come back again and again to voters to ask for the same 18 mill levy.

To the Board of Education
Bellaire Public Schools
Page 6

This information is intended solely for the use of Board of Education and management of Bellaire Public Schools and is not intended to be and should not be used by anyone other than these specified parties.

We are pleased to serve as the School District's auditors. If there are any questions about the audited financial statements or the contents of this letter, we would welcome the opportunity to discuss them when convenient.

Dennis, Gartland & Niergarth

July 27, 2006